

Letter of Findings: 04-20110391
Sales and Use Tax
For the Years 2008 and 2009

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Sales and Use Tax Imposition – "Industrial Production" Exemptions.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-3; IC § 6-2.5-5-4; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of Revenue v. Cave Stone Inc., 457 N.E.2d 520 (Ind. 1983); Indiana Dep't of Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); General Motors Corp. v. Indiana Dep't of Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991).

Taxpayer protests the assessment of use tax on design software and related items Taxpayer argues are subject to the "industrial production" exemptions.

STATEMENT OF FACTS

Taxpayer is an Indiana tool and die manufacturer that specializes in producing molds for its customers. Taxpayer is an S Corporation with a single shareholder. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for the years 2008 and 2009. As a result of the audit, the Department assessed Taxpayer additional sales and use tax. Taxpayer protested a portion of the assessment. A hearing was held on Taxpayer's protest and this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax Imposition – "Industrial Production" Exemptions.

DISCUSSION

Taxpayer maintains that as a manufacturer of plastic injection molds, tools and dies, the purchases of certain items it uses in its manufacturing process are exempt under the "industrial production" exemptions. Specifically, Taxpayer argues that the software it uses (and related items) to design the molds, tools and dies it manufactures for its customers is subject to exemption because Taxpayer sells the designs – along with the particular mold, tool, or die – to its customers; i.e., the designs themselves are a product produced by Taxpayer. Taxpayer cites to [45 IAC 2.2-5-8\(g\)\(7\)](#) in support of its protest.

The Department's auditor took the position that Taxpayer did not sell the software in a retail transaction to any of its customers nor is the software involved in any direct production process but is used before production begins. According to the Department's audit this issue did not come up until the audit was almost completed. Taxpayer was given time to provide documentation to support its claim, but none was forthcoming at that time.

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a sales tax on the transfer of tangible personal property in a retail transaction. IC § 6-2.5-2-1. The industrial production exemption from the sales tax is found in IC § 6-2.5-5-3(b), which states in part that:

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. [45 IAC 2.2-5-8\(a\)](#) further states in relevant part that:

All purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

IC § 6-2.5-5-5.1(b) provides in part that:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture.

As noted in IC § 6-2.5-5-3(b), an exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. Machinery, tools, and equipment are directly used in the production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine,

tool, or piece of equipment (i.e., property) has an immediate effect on the product being produced "if it is an essential and integral part of an integrated process which produces tangible personal property." Id. Further, [45 IAC 2.2-5-8\(c\)](#), example 1, states in relevant part regarding the integrated process:

Because of the functional interrelationship of the various steps and the flow of the work-in-process, the total production process, comprised of such activities, is integrated.

As stated above, Taxpayer refers to [45 IAC 2.2-5-8\(g\)](#), which describes what "have an immediate effect upon the article being produced" and gives some examples to guide interpretation of the regulation. Specifically, Taxpayer points to [45 IAC 2.2-5-8\(g\)\(7\)](#). [45 IAC 2.2-5-8\(g\)](#) states in relevant part:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

–EXAMPLES–

[...]

(6) Computers which are interconnected with and control other production machinery or are used to make tapes which control computerized production machinery are exempt from tax.

(7) Computers which produce designs which are not sold as products are not exempt. Thus, computer-aided design is a nonexempt function.

(8) A computer is used 40[percent] of the time for the purpose described in Example (6) and 60[percent] of the time for the purpose described in Example (7). The taxpayer is entitled to an exemption equal to 40[percent] of the gross retail income attributable to the transaction in which the computer was purchased. (Emphasis added).

IC § 6-2.5-5-4 extends the exemption to tools used to build exempt machinery and equipment.

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described in section 2 or 3 of this chapter.

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) *aff'd* 599 N.E.2d 588 (Ind. 1992) (Internal citations omitted).

Taxpayer argues that the computer software it uses (and other related items) is exempt under IC § 6-2.5-5-4 and [45 IAC 2.2-5-8\(g\)\(7\)](#) as tangible personal property acquired for the direct production of the designs which it sells to its customers as part of the production of the actual mold, tool, or die it produces for its customers.

Subsequent to the hearing and in order to support its argument that it was selling the designs themselves, Taxpayer presented documents from two different customers that set out mold design and building specifications. These design/building specification documents contain language that requires Taxpayer to present any "prints or tracings" of the mold designs to the customer at the end of the production process. Thus, Taxpayer argued that it not only manufactured molds for its customers, but that the designs themselves were also a product it produced and sold to customers and therefore the software used to create the designs, including license renewals of the software and software updates, qualify for the "industrial production" exemptions. In relying on [45 IAC 2.2-5-8\(g\)\(7\)](#), Taxpayer is essentially saying that unlike the example in the regulation (which deals with computers that produce designs that are not sold as products and are therefore not exempt), Taxpayer's computers produce designs that are sold and therefore should be exempt.

Taxpayer's understanding of the "industrial production" exemptions is overly broad. The design process Taxpayer contends is subject to exemption falls into the pre-production phase of Taxpayer's operations. Taxpayer is in the business of producing molds, tools and dies for its customers, the design of the items is part of Taxpayer's process that leads to the production activities. Taxpayer's design services are akin to those services provided by an architect for example. Taxpayer's actual design, like the architect's blueprint, is associated with a service Taxpayer provides its customers in preparation for the actual production of the mold, tool, or die. Furthermore, Taxpayer did not present evidence that shows that it actually sells the designs themselves. For example, that it separately charges for the designs. The fact that Taxpayer's customers request that Taxpayer provide the design at the end of the production process, does not show that Taxpayer actually sold the design.

Based on all of the above, Taxpayer's design software, licenses, and maintenance agreements are not exempt.

FINDING

Taxpayer's protest is respectfully denied.

Posted: 04/25/2012 by Legislative Services Agency
An [html](#) version of this document.